

Memorandum

Date: August 16, 2002

To: Interested parties

From: Department of Water Resources

Subject: Notice of Determination of Revenue Requirement on the Record

Pursuant to California Code of Regulations, Division 23, Chapter 4, Sections 510–517, the California Department of Water Resources (“the Department”) hereby issues notice of its determination of revenue requirements based on the record developed in connection with its proposed determination of revenue requirements issued June 14, 2002. A copy of the determination shall be posted on the Department’s website at www.water.ca.gov. A copy of this notice shall be sent via electronic or U.S. Mail to each person that has requested such notification and to all persons that have submitted comments on the proposed determination.

The determination addresses the Department’s revenue requirements for the period January 1, 2003 through and including December 31, 2003 (or the “Second Revenue Requirement Period”). Also included in the determination is a reexamination and re-determination of the Department’s revenue requirements for the period January 2001 through December 2002 (or the “First Revenue Requirement Period”). The Department has made these revenue requirement determinations in accordance with California Water Code, Division 27 (the “Act”) and California Code of Regulations, Division 23, Chapter 4, Sections 510–517, (“the Regulations”).

The June 14, 2002 Draft Determination projected collections of \$4.699 billion and \$840 million in power and bond charge revenues, respectively. The August 16, 2002 Determination projects collections \$4.648 billion and \$1.140 billion in power and bond charge revenues. The total change in the revenue required is an increase of \$251 million as illustrated below.

Revenue Requirement Change

(\$ millions)

	August 16, 2002	June 14, 2002	Change
Revenue from Customers			
Power Charge	\$4,648	\$4,699	-\$51
Bond Charge	<u>1,142</u>	<u>840</u>	<u>302</u>
Total Revenue Required	\$5,790	\$5,540	\$251

The most significant of changes between the Determinations were:

- 1- The Bond Charge accrual date begins on November 15, 2002. This change was made at the request of the Commission. Beginning the Bond Charge accrual on November 15, 2002 results in an increase in revenue received from Customers in

2003 of \$138 million. The increased revenue eliminates the need for transfers from the Operating Account to the Bond Charge Collection Account in 2003.

- 2- Debt service increases by \$58 million in 2002 due to an increased bond par amount. The change in bond par amount is primarily due to an increased deposit to the Operating Account required by the credit rating agencies to secure acceptable credit ratings.
- 3- Energy costs in 2002 increased by approximately \$28 million due to a modification to the generation dispatched from one specific long-term contract. The change results in a decrease in Department contract generation, and a corresponding increase in residual net short in the remainder of 2002.
- 4- Energy costs in 2003 are expected to be approximately \$25 million higher than originally projected. This change is due to continued due diligence on energy contract dispatch estimates.

In addition to these significant changes, the change in projected bond issuance dates from August 15, 2002 to October 10, 2002 results in different repayment amounts for the State General Fund advances and the Interim Loan as well as different power and bond account initial deposit requirements.

PUBLIC PROCESS

In reaching its determination of revenue requirements, the Department followed procedures consistent with those contained in the Act and the Regulations. On June 14, 2002, the Department issued a proposed determination to the persons or entities that provided comments or requested notice of the prior determination dated November 5, 2001, and to other persons or entities who requested notice of this current revenue requirement determination. Additionally, a copy of the Department's proposed determination was posted on its web-site, <http://www.water.ca.gov>. The deadline for submitting comments on the proposed determination was July 5, 2002.

The Department held a workshop at 12:30 p.m. on June 19, 2002, at the Auditorium of the Employment Development Department, 722 Capitol Mall, Sacramento, to review its proposed revenue requirement determination with members of the public. Additionally, and within the comment period, the Department sponsored a series of four conference calls with interested parties which were held on July 1 through 3, 2002 and one on July 8, 2002, allowing parties to ask questions and receive information pertaining to the proposed determination. In response to comments and questions raised during its public comment process, the Department has noticed for comment additional significant material relied upon in its determination of a revenue requirement pursuant to the Regulations. The Department has reviewed all comments timely submitted in accordance with the Regulations and has made an assessment as to whether matters raised in those comments have a material impact on the

Revenue Requirement. To the extent changes were necessary they have been incorporated within the Department's determination of revenue requirements attached hereto. The most significant of such changes was a revision to the amount of load under direct access in the service areas of the three Investor-Owned Utilities ("the IOUs"). Though this change was meaningful for each utility, there was no significant change statewide. The Department has also considered comments submitted by members of the public in reaching a determination that its revenue requirements for the First Revenue Requirement Period and the Second Revenue Requirement Period are just and reasonable.

BACKGROUND

The Department assumed responsibility for the purchase of the net short energy requirements of the retail customers of the IOUs on January 17, 2001 when the IOUs were no longer creditworthy and could not purchase energy in the market. On February 1, 2001, Assembly Bill 1 from the First Extraordinary Session of 2001 was enacted into law ("AB1X"), which provided among other things statutory authorization for the Department to purchase the net short energy requirements of customers in the IOUs' service territories. The Department has acquired the net short energy requirements of the three IOUs during the First Revenue Requirement Period using a combination of long term contracts with the residual net short, i.e., the difference between supply from long term contracts and the net short, met by a portfolio of shorter term contracts and the spot market. The costs of the Department's purchases to meet the net short requirements of the customers of the IOUs are recovered from payments made by the customers and collected by the IOUs on behalf of the Department.

The Department has funded its purchases for energy from January 17, 2001, to date from a combination of customer revenues collected by the IOUs on behalf of the Department, advances from the State General Fund, and the proceeds of an interim financing of \$4.3 billion in June 2001 (the "Interim Loan"). Approximately \$ 7 billion of power costs paid by the Department to meet the net short energy needs of the Customers have not yet been reflected in retail electric rates. The Department expects that these costs will be reimbursed from the proceeds of a revenue bond financing, the costs of which will be made from the Bond Charge established in the Rate Agreement between the Department and the California Public Utilities Commission.

The Department's determination of revenue requirements includes a presentation of the residual net short requirements of the IOUs both in terms of volumes and expected costs for the second revenue requirement period. Pursuant to AB1X, however, the Department's power charge-related revenue requirements does not include any amounts for the provision of the residual net short of the IOU's during the Second Revenue Requirement Period. This is consistent with the sunset of the Department's authority to enter into power contracts on December 31, 2002.